In the Matter of:

Enoch Adams, Jr., et al. v. Teck Cominco Alaska, Inc., et al.

February 23, 2005
Michael Kavanaugh

Condensed Transcript with Word Index

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A. I use it. I'm not going to say that everything in Brealey and Myers is uncontroversial.

Q. Can you identify something for me that you think is controversial?

A. I haven't been through the entire book in a while, but certainly as a text, it presents the basics and takes you out to the edge of the envelope.

So when you get to that edge, I would imagine that there are others that have other opinions about parts of it.

Q. During the last six months, have you read any professional journals that cover topics and developments in the academic field of corporate finance?

A. Six months?

Q. Yes.

A. Maybe not, no. Probably not.

Q. I would like to go to page 5 of your expert report. Looking in Section 3, "Application of Economic Benefit Model," after

the series of four bullet points, there is a statement, "The benefit is calculated using an equity cost of capital and, alternatively, a weighted average cost of capital." Do you see that?

A. Yes.

Q. I'm not an economist. You will have to explain this to me in layman's terms. The benefit here, we are talking about economic benefit; is that correct?

A. That's correct.

Q. And can you tell me what you mean by economic benefit in the context of this case?

A. Yes.

Q. Would you do that, please.

A. The economic benefit is a term that is a shorthand for a sum of money that if you would remove from the defendant today would put it in the same financial position as if it had complied in the past.

Q. You say this benefit is calculated using an equity cost of capital. What is equity

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cost of capital? Can you give that to me in layman's terms?

A. That would be the return on an investment that could be earned in a project of average risk using equity as a way of paying for the project.

Q. So normally when I think of equity, I think of some shareholder coming in or potential shareholder and putting down money to buy shares in a corporation with some expectation of return. Is that what we are talking about here?

A. That would be a fair characterization.

Q. Is there a better characterization?

A. Well, why don't we talk about what it is not. It is not borrowing money. It is issuing an equity instead of a debenture for that money.

Q. So when you are looking at equity cost of capital, is it correct that you are looking at it from the standpoint of whoever that investor is that is putting up the capital?

A. The shareholder, from the owner's point

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of view.

Q. So if it is a corporation, it would be a shareholder?

A. Yes.

Q. You say "alternatively, a weighted average cost of capital." Could you explain what weighted average cost of capital is in layman's terms?

A. Yes. Where before we were talking about funding the project with just shareholder or owner dollars, now we are bringing in money that can be borrowed. So we have two sources of the funds, the equity and the debt, and the proportions are weighted.

In other words, by looking and evaluating what should have been spent for pollution control, I am looking at it as some equity and some debt, and the proportions of equity and debt I'm referring to as a weighted average.

Q. How do you decide how to weight that, how much you put to equity and how much you put

to debt?

A. Yes. I look at the proportions of debt and equity, in this instance, the proportions of debt and equity on the parent's balance sheet.

Q. So you didn't look at Teck Cominco Alaska, Incorporated's balance sheet; you looked at some other balance sheet for that?

A. I looked at Teck Cominco Alaska's parent's balance sheet.

Q. Whose balance sheet is that when you say "parent"?

A. This is the problem I was anticipating when we began this. This would be Teck Cominco Limited, if I understood our definitions at the beginning.

Q. Don't go back to the definitions at this point. I am just trying to figure out what information you looked at.

So if it is easier, we can turn back to page 11.

A. Let me go to page 12.

Q. Yes.

A. That's where I'm talking in the middle of the page about the publicly available financial records of Cominco Limited and Teck Cominco.

Q. There you say "Teck Cominco." You mean Cominco Limited and Teck Cominco. What does "Teck Cominco" mean there on page 12?

A. That's what I call the parent of Teck Cominco Alaska, Incorporated. That's the entity that owns the Red Dog Mine and other mines and businesses around the world.

Teck Cominco is the one that's headquartered in Vancouver and has among its properties the Red Dog Mine, which I see as the same as Teck Cominco Alaska, Incorporated.

Q. Why do you see them as the same? Isn't a parent and a subsidiary separate corporations?

A. Wait a minute. Red Dog Mine is Teck Cominco Alaska, Incorporated. Teck Cominco Alaska, Incorporated has no other entities but Red Dog Mine. Isn't that correct?

It is my understanding that Teck

Cominco Alaska, Incorporated's only asset is the Red Dog Mine.

Q. And what is the relevance of that in this case?

A. Well, none. I thought you were challenging or saying that --

Q. No. What I'm asking is -- let's go back to square 1. I'm sorry to confuse you.

Page 12, "Publicly available financial records of Cominco Limited and Teck Cominco." Do you see that?

A. Right.

Q. When you say "Teck Cominco" in this sentence here, are we referring to the parent corporation that you were describing or are we referring to Teck Cominco Alaska, Incorporated?

A. The parent corporation.

Q. My next question was is the parent corporation you are referring to, is that Teck Cominco Limited, the Vancouver corporation?

A. Yes.

Q. And then my next question, which I

think we were sort of there, but maybe not -- maybe it wasn't clear enough -- is why were you looking at the financial records of Teck Cominco Limited to get this weighting that you were using -- I guess call it WACC for short -- for this calculation?

A. I understand the question now. I looked at the parent because I thought that the parent was the better entity to use to value the funds because the parent had the use of the funds, that the funds made available by avoiding and delaying compliance with the TDS weren't simply at the disposal of Teck Cominco Alaska, Incorporated but were available to the parent.

Q. Were those funds used by the parent?

A. I would assume so.

Q. Do you know?

A. Well, with money being fungible, you just can't know these things.

Had Teck Cominco Alaska, Incorporated complied with the permit, it might have had to go to Teck Cominco to get funding. Those funds

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then remained with Teck Cominco to go and conduct operations and buy things throughout the world.

Q. Would that economic benefit then have been enjoyed by Teck Cominco Limited?

A. Yes.

Q. Did you review responses to discovery from Teck Cominco in this case pertaining to the financing between Teck Cominco Alaska and Teck Cominco Limited?

A. I don't recall that, unless it's in the Teck Cominco Alaska, Incorporated consolidated financial statements. But that would be a document. So I think the answer is no.

Q. Going back to page 5. We were talking about this equity cost of capital and the WACC alternatives. Is that proper to call it WACC?

A. That's proper.

Q. Between those two options, I guess you discussed those as alternatives.

A. Yes.

Q. Then I can't point to it, but somewhere

A. You could certainly use it to stand in 1920 and look forward. It would be an interesting historical project. But that's not an interesting question to a lot of academic economists. So they don't ask it.
Q. My understanding of the way you are using the CAPM here is you are taking us back in time and saying if Teck Cominco Limited, the parent, had this money, this is what they could have earned on it?
A. Yes. Basically, going back to June 1, 1998, by not spending the money for a feasibility study, a pilot plant and a suite of projects, they made available to them a sum of money that they could then use in other remunerative projects.
Q. What is confusing me is why do you have to go back in time and use a model that I understand to be predictive to give you what you already know?
A. You don't already know it.
Q. Don't you know what the tax rates were

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